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Television Industry Summit 2002

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Federal Communications Commission
Office of the Secretary

The Case for Deregulation in the Television Business

02-277

ORIGINAL

THE CASE FOR DEREGULATION. Bear Stearns hosted a TV Industry Summit in Washington, D.C., on November 26 to look at current and future prospects for the network and local TV business. Audience fragmentation, a consolidating cable business, escalating programming costs, competing technology, and reliance on a single revenue stream could all hurt the free, over-the-air model if left unchecked.

- **BROADCASTERS WANT A LEVEL PLAYING FIELD WITH THE CONSOLIDATING CABLE BUSINESS.** Broadcasters are concerned about cable's gatekeeper function, especially in markets where cable operators dominate. Cable consolidation makes cable systems more competitive with local advertising and programming and makes future retransmission payment discussions for local TV stations more difficult; as such, broadcasters want increased national/local regulatory flexibility.
- **LOCAL TV BROADCASTERS WANT A CHANCE TO COMPETE WITH NATIONAL PLAYERS.** Local TV broadcasters will press for newspaper/broadcast and duopoly relief so that they can 1) create strong local media franchises to level the competitive playing field with large national media players and 2) counteract economic pressures on the local TV station model.
- **NATIONAL BROADCASTERS WANT TO AMORTIZE OPERATING COSTS OVER LARGER STATION PLATFORMS.** The broadcast networks have launched cable networks, syndicated TV shows, and cut affiliate compensation to improve profitability. However, given the diminishing future benefits of these factors, networks will likely appeal to the FCC to loosen national ownership caps, which will permit them to amortize their costs over larger station platforms.

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TV Industry Summit

Television Industry Summit 2002

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November 26, 2002

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November 26, 2002

**BEAR
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Victor Miller, Raymond Lee Katz, and Kevin Gruneich

Invite You to Attend the
Television Industry Summit
Tuesday, November 26, 2002
8:15 A.M.-4:15 P.M.
Loews L'Enfant Plaza
480 L'Enfant Plaza, SW
Washington, D.C.

Panels Discussing:

- Impact of Cable Networks, MSOs, DBS, and PVRs on Viewership and Advertising
 - Economics of Local TV Broadcasting — Revenues and Expenses
 - Issues Facing the TV Business — Washington Perspective
 - Health of Small- and Mid-Market Television
 - Duopoly and Cross-Media Ownership
 - Broadcast Network Economics
 - Digital TV Update

Experts Include:

David Barrett (Hearst-Argyle), Bruce Baker (Cox TV), Jonathan Blake (NBC, CBS affiliates), Gary Chapman (LIN), Robert Dechard (Belo), David Donovan (MSTV), Randy Falco (NBC), Jerald Fritz (Allbritton), Wade Hargrove (ABC Affiliates), Jim Keelor (Liberty), John Lansing (E.W. Scripps), Paul McTear (Raycom), Kevin O'Brien (Meredith), Nat Ostroff (Sinclair), David Poltrack (Viacom), Chris Rohrs (TVB), Greg Schmidt (LIN), Shaun Sheehan (Tribune), David Smith (Sinclair), Jeff Smulyan (Emmis), Perry Sook (Nexstar), Walter Ulloa (Entravision), Tony Vinciguerra (Fox), Dick Wiley (Wiley, Rein & Fielding), Jim Yager (Gray), and More to Be Named Later.

Agenda

Time	Presentation
145 a.m.	Continental Breakfast and Conference Registration
8:15	Opening Remarks
8:30	Impact of Cable, DBS, and PVR Competition on Viewership and Advertising <i>David Barrett, President and Chief Executive Officer, Hearst-Argyle Television, Inc.</i> <i>Jerold Fritz, Senior Vice President, Legal and Strategic Affairs, Allbritton Communications Company</i> <i>John Laming, Senior Vice President, Broadcasting, The E.W. Scripps Co.</i> <i>Chris Rohrs, President, Television Bureau of Advertising</i>
9:45	The Economics of Local TV Broadcasting — Revenues and Expenses <i>Bruce Baker, Executive Vice President, Cox Television</i> <i>Gory Chapman, Chief Executive Officer, LIN TV Corp.</i> <i>Kevin O'Brien, President, Broadcasting Group, Meredith Corp.</i> <i>Jeff Smulyan, Chairman, Emmis Communications</i>
11:00	Duopoly and Media Cross-Ownership <i>Robert Decherd, President and Chief Executive Officer, Belo Corp.</i> <i>Shaun Sheehan, Vice President, Washington, Tribune Company</i> <i>David Smith, Chief Executive Officer, Sinclair Broadcast Group</i> <i>Walter Ulloa, Chairman and Chief Executive Officer, Entravision Communications Corporation</i>
12:00 p.m.	Broadcast Network Economics <i>Tony Vinciguerra, President and Chief Executive Officer, Fox Networks Group</i> <i>Randy Falco, President, NBC Television Network</i> <i>David Poltrack, Executive Vice President, Research and Planning, CBS Television</i>
1:15	The Health of Small- and Mid-Market Television <i>Jim Keelor, President and Chief Operations Officer, Liberty Corporation</i> <i>Paul McTear, President and Chief Executive Officer, Raycom Media, Inc.</i> <i>Perry Sook, President and Chief Executive Officer, Nexstar Broadcasting Group, Inc.</i> <i>K. James Yager, Chief Operations Officer, Gray Mid-America Television, Inc.</i>
2:15	Digital TV Update <i>Jonathan Blake, Partner and Head of Telecom and Media Practice, Covington & Burling</i> <i>Nat Ostroff, Vice President, New Technology, Sinclair Broadcast Group, Inc.</i> <i>Greg Schmidt, Vice President, New Development & General Counsel, LIN TV Corp.</i>
3:15	Issues Facing the Television Business — Washington Perspective <i>David Donovan, Chief Executive Officer, MSTV</i> <i>Wade Hargrove, Partner, Brooks, Pierce, McLendon, Humphrey & Leonard, L.L.P.</i> <i>Richard Wiley, Managing Partner, Wiley, Rein & Fielding LLP</i>
4:15	Summit Conclusion

Executive Summary

Bear Stearns acted as a financial advisor to AOL Time Warner Inc. in its pending transaction with Comcast Corp. involving the restructuring of Time Warner Entertainment.

Sinclair Broadcasting Group has retained Bear Stearns to advise on market opportunities and make strategic recommendations.

Bear Stearns acted as a financial advisor to Northcoast Communications LLC in its pending asset sale to Verizon Wireless.

Paxson Communications Corporation has retained Bear Stearns to advise with regard to strategic alternatives.

On November 26, 2002, Bear Stearns hosted a Television Industry Summit in Washington, D.C., to look at current and future (five-year) prospects for the network and local TV business.

Concerns with audience fragmentation, a consolidating cable business, escalating programming costs, competing technology, and reliance on a single revenue stream were paramount, as all would likely threaten the free, over-the-air model if left unchecked.

During the eight-hour discussion, which featured **25** industry leaders, four important themes emerged, which we discuss below.

CABLE CONSOLIDATION IS A REAL THREAT TO THE TELEVISION BUSINESS

Participants at our TV Summit suggested that the broadcasters' biggest threat is the consolidation of the cable business.

- **Cable as Gatekeeper.** Broadcasters are concerned with cable's gatekeeper function, especially in light of many cable operators' dominant local competitive positions. For example, we believe that the merger of Comcast and AT&T's cable systems will leave Comcast with a 98%, 96%, 98%, and 97% share of the "wired" cable business in Chicago, Philadelphia, San Francisco, and Detroit respectively. All four of these are top ten media markets.
- **Competition from Local Cable Ads.** Broadcasters are concerned with local cable advertising inventory, which has really started to emerge as competition to local TV station ad sales, especially as the cable business becomes more geographically concentrated. We estimate that local cable systems capture local advertising in an amount equivalent to a fifth- to sixth-ranked (in terms of ratings) local TV station. During the last few years, local cable ad growth has accelerated at a pace faster than that of local TV station ad sales. For example, we think that Comcast/AT&T capture nearly \$1 billion in local cable ad sales, which exceeds the ad sales captured by the Walt Disney Company's owned and operated (O&O) TV stations. That is a significant development.

**THE BROADCAST
TELEVISION BUSINESS
NEEDS A SECOND
REVENUE STREAM**

- **MSO Encroachment.** Broadcasters are worried that multiple system operators (MSOs) are developing competitive local programming, especially in local news, weather, traffic, and entertainment/culture channels.
- **Cross-Ownership Confusion.** Broadcasters cannot understand why an entire **local** cable system counts as one voice for local radio/TV cross-ownership rules and does not count at all in local TV ownership rules. To broadcasters, that an entire cable system should count **as** only one voice seems indefensible in the first place. Moreover, that cable counts as a de facto competitor to radio (because it is included in radio cross-ownership rules) and does not in TV ownership rules makes little sense.

The entire national and local television business is essentially a one-revenue-stream business, relying almost solely on advertising. Broadcasters must look at the cable network model for inspiration, we think.

The cable network business has no over-the-air distribution (translation: it is wholly reliant on cable/direct broadcast satellite systems to distribute its content), and audiences are significantly smaller than those of any one broadcast network. However, cable networks' collective cash flow dwarfs that of the broadcast networks. Why? These cable networks receive subscriber fees. Without these subscriber fees, the collective profits of the cable networks would be at levels similar to the broadcast networks, we believe.

As **1)** advertising inventory loads across the whole broadcast network and cable network and television station businesses start to reach theoretical limits (minutes per hour are reaching the point where adding more inventory could drive away audiences), **2)** new technology threatens the veracity of the advertising model, and **3)** the cost of programming continues to increase at the national and local level, there will be some pressure to try to develop new revenue streams, including retransmission payments.

Interestingly, we may be reaching an interesting historical point in the retransmission battle between local television stations and cable systems. Since 1993, the year of the original retransmission/must-carry negotiations, the broadcast networks, led by ABC, have chosen to either launch a new cable network or increase the distribution of existing cable networks. Cable networks such as ESPN, ESPN2, MSNBC, The Disney Channel, CNBC, F/X, Fox News Channel, TV Land, Nickelodeon, and The National Network, to name a few, have all benefited from retransmission consent negotiations. But while the broadcast networks were creating huge value, the local TV stations did not secure any meaningful amount of anything.

In theory, if the "big four" (ABC, CBS, NBC, and Fox) networks and their affiliated TV stations could capture as much on a per subscriber fee or a "dollar per average viewer" basis as the average cable network then retransmission dollars **would** approximate \$2 billion-plus. Now, while it is extremely unlikely that broadcast networks could negotiate this type of value and that cable systems would pay that much, it still raises the point that currently, the local TV business captures very little through retransmission consent negotiations. At some point, stations will finally explore the potential of retransmission.

Why now? Because the broadcast networks theoretically might start to pay attention to retransmission consent payments themselves. As mentioned, in the past, the broadcast networks decided to launch and/or increase the distribution of their cable networks. However, the last two up-front seasons have not been particularly healthy for the cable network business relative to the broadcast network business. This reflects the fact that there is just too much cable network advertising inventory relative to broadcast network inventory in the marketplace. We estimate that only **4%** of total national TV inventory runs on the broadcast networks during any given week.

So, if the broadcast networks, whose corporate parents own **16 of** the top **20** rated cable networks, may come to the conclusion that launching another new cable network concept into a market already saturated with advertising inventory is not optimal, capturing retransmission economics **for** local TV stations may gain interest. **In** addition, most cable networks are nearly fully distributed, so using retransmission consent negotiations for that purpose may also be running its course.

We will continue to monitor developments here, but we do believe it is important for local television stations to diversify their revenue streams. This may ultimately become an option. In our opinion, this will be among the most contentious issues in broadcasting and cable over the next three years.

For more on this topic, please the article coauthored by Raymond Lee Katz and Victor Miller entitled "On the Radar Screen: The Coming Retransmission Wars?" in **Mr. Katz's Cables & Bits: Cable TV & Broadband Newsletter** dated January **14, 2003**.

**OPERATING
LEVERAGE IN THE TV
BUSINESS IS HIGH**

Another reality confronting the local TV business is its high operating leverage. The TV business consolidated at a quicker rate (relative to radio) immediately after the Telecommunications Act of **1996** was signed and digested another wave of consolidation after August 1999's rulemaking that begat duopoly. Because of this, the TV business has effectively completed much of its recent consolidation phase and the cost saving benefits of that phase to date.

As such, when revenue falls, local TV operators are not able to look to cost savings to make up the difference in generating cash flow; costs have essentially been "wrung out of the business" and, if anything, are starting to increase modestly. TV's operating leverage was very evident in 2001, when the industry's revenues declined 10%-15%, and cash flow **for** the broadcast business declined at a rate of 25%-35%.

Given the fixed-cost nature of the TV business, cash flow is very vulnerable to changes in the revenue line. This suggests that TV broadcasting companies need to 1) create new revenue streams and 2) create new opportunities to foster efficiencies.

Without **an** intermediate-term course of change, the pressures that continue to build on the revenue line from cable networks, local cable systems, fractionalizing audiences, etc., combined with the fixed-cost nature of a typical station's cost base, could place pressure on the cash-flow-generating ability of a local TV station.

TECHNOLOGY IS A PENDING THREAT TO TV

Technology such as personal video recorders (PVRs), which have commercial skipping potential, are a pending threat to the TV business. Data from early adopters of the PVR technology suggest that commercial skip rates are 400% higher with PVRs such as TIVO and Replay than with the traditional technology, the video cassette recorder (VCRs).

Since the local and network television business relies on advertising solely for its source of revenue, the future potential impact of PVRs on the television business must be closely monitored, especially as the technology enters the cable set-top box.

If the advertising model is sufficiently weakened, consumers would, theoretically, ultimately have to pay higher subscriber fees, or the broadcast service and quality of 2,000-plus hours of original programming may suffer. We estimate that if the entire ad model went away, cable bills would reach nearly \$100 per month in order to replace lost ad dollars. We do not believe the FCC would want to see a scenario like that pan out.

NETWORKS AND AFFILIATES MUST START VIEWING THE INDUSTRY AS ONE INDUSTRY

And now, a word from the TV Summit's sponsor. The following are comments that, while not specifically addressed by the panels at the conference, were discussed in our opening remarks and reflect our opinion. With that caveat, we believe it is time for the networks and their affiliates to begin to speak with one voice: the voice of the "over-the-air broadcaster."

We feel it is important that the entire television business, which includes the broadcast networks and their affiliates, to start viewing the industry holistically and that the "us versus them" mentality that has crept into the television business in general is harmful.

Interestingly, when you look at the pressure bearing down on both businesses (broadcast networks and local stations), the list of concerns is identical: 1) a consolidating cable business, 2) technology, 3) increasing costs, 4) a fractionalizing audience from more video competitors, and 5) reliance on a single revenue stream.

Theoretically, this industry should be more closely aligned in order to address these concerns. But local stations also have to contend with the issue of the networks, and the affiliates' focus has been placed here instead of on all the commonalities that confront the industry as a whole. This is unfortunate, in our view.

Broadcast networks want the ownership caps to be raised to help amortize their marginally profitable network models over a greater local TV station base, where profit margins are much higher and more stable. This should, in theory, ensure the health of the broadcast network business. And the health of the broadcast networks is essential for the health of the local station business; local stations' profit margins during network programming time periods are very significant because there is no theoretical cost associated with those time periods.

For example, during prime-time shows, the local station receives approximately 25% of the ad inventory during a given show (actually, the commercial time given to the local affiliate and O&O tends to be the commercial time that airs between shows). There really is no cost associated with the "acquisition" of a prime-time program.

Local stations are given inventory to essentially “clear” the program. Suffice it to say that this is a high-profit-margin business for the local affiliate.

While networks would like to expand station bases, local (non-network-owned) broadcasters would like to increase their presence in local markets to stave off competition from national media players (broadcast networks, cable networks, programmers). That is why a reprieve from current newspaper/broadcast cross-ownership regulations and tolerance of duopolies in more TV markets are near and dear to local broadcasters’ hearts.

Cooperation between the networks and their affiliated stations, in which the two find common ground, could only advance any prospects of deregulation in the TV business, we believe.

In general, there seem to be three major sticking points among the affiliates relative to their networks: the right to reject rule, the right to assign, and programming sourcing.

The Right to Reject Rule

The right to reject rule allows a local broadcaster to preempt network programming if the programming is deemed inappropriate for local audiences or if the local station wants to air programming that it feels would be of more interest than network offerings.

On the right to reject issue, it seems as though ample guidance is already provided by existing statutes. The statute reads as follows.

“Right to reject programs. No license shall be granted to a television broadcast station having any contract, arrangement, or understanding, express or implied, with a network organization, which, with respect to programs offered or already contracted for pursuant to an affiliation contract, prevents or hinders the station from 1) rejecting or refusing network programs, which the station reasonably believes to be unsatisfactory or unsuitable or contrary to the public interest, or 2) substituting a program, which, in the station’s opinion, is of greater local or national importance.”

This suggests that local TV stations do have some latitude in preempting network programming. Perhaps **networks** should adapt right to reject language codified by these existing statutes in affiliation agreements with their affiliates.

However, the local TV stations should also take another view of the right to reject rule. They should not be able to preempt shows merely to make revenue and cash flow budgets without first making a network reasonably whole on its programming investment.

Restoring the statutes’ language and negotiating a fair agreement between networks and affiliates on “preemption purely for local station benefit” seems like a **logical** approach.

The Right to Assign

The right to assign rule permits a seller of a local TV station to transfer the ownership of the station to a new owner with little or no permission needed from the network.

On the right to reject front, we believe that networks should permit well-qualified acquisition candidates to acquire and operate a station that has been sold in an open and free market. Broadcasters should be able to develop properties without fear that a network will threaten to rewrite affiliation agreements and/or limit the number of potential buyers of a property.

Program Sourcing

Non-network-owned TV stations are concerned that the network players are slowly becoming the only source of programming. This issue may even cloud affiliates' view of the type of deregulation, loosening the ownership caps, that networks desire.

Since the financial syndication rules were erased in **1994**, the TV industry has seen a significant decline in independently produced programming. This implies that networks have taken progressively more ownership in their prime-time schedule.

The concern is that if the networks can expand ownership reach, the programming source issue may be exacerbated. Since syndicated television shows require at least 70% coverage of U.S. TV households to be successful, in general, it is feared that O&O groups will not favor independent productions. And if the cap moves north of 35%, it will theoretically be difficult for any independent program to reach the marketplace without the support of network-owned stations.

Admittedly, while the right to reject and the right to assign rules **are** theoretically a little easier to tackle, this one is more difficult.

However, it does seem that we are again at a historical point that might make the dynamic change somewhat. The reality is that every year, new television shows come into the syndication market.

However, despite the increase in ownership of prime-time fare, very little "off-net" (programming that came from prime-time schedules) syndicated programming is entering the marketplace, **as** there are fewer and fewer programs that 1) run for at least four years (the minimum number of years required to create a viable, syndicated product) and 2) are appropriate vehicles for local TV (for example, sitcoms, not hourlong dramas).

Also, the number of available time periods for syndicated programming, whether "made-for-syndication" (shows that air without a "run" on the networks) or "off-net," is not expanding at a similar rate to the increasing supply of programming available, especially in the morning (9:00 A.M. to 12:00 P.M.), early fringe (4:00 P.M. to 5:00 **P.M.**) ,the prime-time access hour (7:00 P.M. to 8:00 P.M.) and late fringe (1030 P.M. for **Fox**, **WB**, and **UPN** affiliates).

So, it may pay for the networks to integrate local TV stations into the development of some made-for-syndication television programs. Network programming arms could share some upside in the economics of a show with local stations in order to reduce the ~~risk~~ that a programmer ~~often~~ faces in assembling a meaningful station lineup. (Its just a thought.) Networks are unlikely to share the profit potential, and we doubt that local TV stations would be willing to participate in the financial ~~risks~~ of prime time.

Meaningfully resolving some or all of the above three issues would go a long way toward dissipating the tension that has built up between the networks and their affiliates, we believe. Moreover, alignment ~~between~~ these two over-the-air broadcast forces could ultimately bring this industry to another level. We believe it is time for the industry to move ahead with one point of view (~~as~~ close ~~as~~ that can be done) ~~as~~ it relates to deregulation. A divided ~~industry~~ will lead to less-than-optimal scenarios. Another deregulatory environment is unlikely to materialize anytime soon, so time is of the essence.

WHY SHOULD NETWORKS AND THEIR AFFILIATES COOPERATE?

The FCC Is Unlikely to Be Partially Deregulatory

Another reason why we believe that the time is now for the broadcast networks and affiliates to cooperate is that we think it is unlikely that the Federal Communications Commission will be partially deregulatory.

If the FCC loosens local ownership rules — namely, the broadcast-newspaper cross-ownership rules and the duopoly rules — it seems inconsistent to us that it would do nothing on the network ownership cap issue. Here's why.

First, multiple system operator national reach caps (was **40%** of all multichannel households, but that reach cap is currently being reviewed by the FCC ~~as~~ required by the appeals court, which remanded the issue back to the commission) are already at higher levels than TV reach caps. However, while an MSO can essentially control an entire market's cable business, a single local TV station (or a duopoly situation, for that matter) could never replicate the kind of market share that cable MSOs enjoy. This may create some sort of precedent for ownership caps in TV and may make it harder for the commission to ignore changes in the network ownership cap.

Second, we find it difficult to understand why the affiliates would not want to take advantage of the loosening of the ownership caps themselves. If the national ownership cap was raised, there is no obligation for a local TV station owner to sell to a network player, especially if the commission upholds the right to assign language in its existing statutes. An affiliate (non-owned and operated) seller could sell to another affiliate player. And ~~as~~ the affiliate players gain scale, they could likely increase their relative bargaining positions with broadcast networks, cable multiple system operators, and programmers. By defending the rule, it makes it appear that affiliates themselves can not be opportunistic, which is an unfair characterization of the industry, we believe.

Third, there is immense pressure from the appeals court on the commission to justify any rule change or any decision not to change rules, and the appeals court has already struck down the most offensive ownership rule, the cable/broadcast cross ownership rule. If the FCC made no change to the cap, the networks would likely take the issue

to court the next day. We just do not believe that the courts are likely to allow the Federal Communications Commission to issue rules that only partially deregulate the business.

Fourth, the Telecommunications Act of 1996 states that ownership rules be revisited every two years and that only those that are “necessary in the public interest” should be retained. The FCC’s Republican majority’s interpretation of “necessary” (really necessary) relative to the Democratic interpretation (convenient) could favor rule changes, as the commission recognizes Congress’s will as well.

Ultimately, as we have stated often before, we believe that this commission will look to strike a balance between the reality of the marketplace, the precedent of the courts, the interpretation of Congress’s will, and the public interest. And we think that the commission, under Chairman Michael Powell’s leadership, will accomplish just that.

While we can understand many of the concerns of the affiliates on the cap issue, we simply believe that the cap is unlikely to remain in place as is. If our logic is correct, then the industry should focus on creating consistent, more robust positions on deregulation.

The bottom line is that the broadcast networks and stations are “married to the same terrestrial system” (thanks to panelist Jeff Smulyan of Emmis Communications for that) and that the overall health of the television business is essential for the continued health of its components. Healthy networks beget healthy stations, and healthy stations beget healthy networks. Smaller issues should not set the tone of relations between the parties.

THE CASE FOR DEREGULATION

Preserving the Free, Over-the-Air Television Business

When we introduced all of the panels at the TV Summit, we reminded the panelists that our focus was to determine the relative health of the TV business five years down the road. Ultimately, we were asking, what does the network business and the affiliate business look like in 2007-08?

In our framing of the broadcast network and local TV station models, we tried to have panelists address the threats posed by 1) fractionalizing audiences, 2) a consolidating cable industry, 3) an oversupply of advertising inventory, 4) escalating programming costs (local news for stations and prime time/sports for the broadcast networks), 5) reliance on a single revenue stream, 6) the threat of technology, and 7) in the case of the local stations, the power of the broadcast networks.

The central theme of many of the panels was that, if left unchecked, many of these factors could have a significant impact on the health of the broadcast business in the future. And, because the operating leverage in the television business is significant, modest changes in revenue can have a more-than-modest impact on broadcast cash flow, given the generally fixed-cost nature of the TV business. With this in mind, our panelists seemed to suggest the following.

- Local Broadcasters Believe Newspaper/Broadcast Cross-Ownership Rules Should Be Relaxed. Newspaper/broadcast cross-ownership rules should be

relaxed to allow local media companies to secure stronger local media franchises to fend off encroaching national and local competition. This rule has not changed since **1975**. In fact, one could argue that while broadcast networks received relief in the form of the relaxation of ownership caps (to **35%** from **25%**) in the Telecommunications Act of **1996**, and that local broadcaster were afforded relief in terms of how many stations they could own (from **12** total to an unlimited amount, limited only by the 35% national reach cap) in the Telecom Act and also won duopoly relief in the August **1999** FCC rulemaking, the newspaper business has not **earned** any such relief. If any industry is due, it's the newspaper industry.

- Broadcasters Believe That Duopoly Relief Should Be Extended to More Markets. The duopoly rules should be relaxed to promote operating **efficiencies** and new programming services in midsize to smaller TV markets, **as** have been achieved in the largest TV markets to date. However, one could easily make the argument that duopoly is much more necessary in smaller TV markets than in larger markets; the economics of standalone stations in small markets are often considerably less attractive than those in large markets because, while a TV station in market **120** may have **20%** of the income that a top ten market TV station enjoys, that same station will probably have 33% of the expense base relative to a top ten station. This implies that smaller-market TV stations generally enjoy much lower margins. Operating efficiencies are needed in the midsize to small markets, especially in light of network compensation cuts common in those markets. Network compensation represents proportionally more revenue and cash flow in market **120** than it does in market **10**.
- Networks Believe the Ownership Cap Should **Be** Relaxed. The broadcast networks, which earn relatively little in profits relative to their **\$16** billion in revenue, are looking to the deregulation of the national ownership cap because it will allow them to amortize the significant cost required to run a broadcast network over **as** much of a distribution base **as** possible. Essentially, broadcast networks are using their highly profitable local TV stations to increase the overall profitability of their TV operations.

Our seven panels featured **25** industry leaders from **18** broadcast companies, **two** industry trade associations, and three prestigious law firms. We hope you find this report useful. Should you have any questions on the topics discussed during the TV Summit, please call Victor Miller at **212-272-4233**.

Opening Remarks

Victor Miller, Senior Managing Director, Bear, **Stearns & Co.** Inc.: I'm Victor Miller, the TV and radio broadcasting equity analyst for Bear Stearns; and on behalf of **Ray Katz**, Bear Stearns' large-cap entertainment equity analyst, and Kevin Gruneich, Bear Stearns' publishing and information service equity analyst, I would like to thank you for attending the TV summit here in D.C.

I want to wholeheartedly thank the many executives in the television industry who have come from far and wide to give their time to this event. The sessions today would not have been possible without your support. I also want to thank the Federal Communications Commission and members of the Senate and House Commerce Committees and hope you find these sessions informative and useful. I would also like to welcome our friends from the mutual fund and money management business and extend a welcome to the press **as** well. I want to introduce you to Chris Ensley, Tracy Young, and Debaki Chakrabarti; they're also part of our media broadcast team. They make me very proud of what we do at Bear.

"We are hopeful that the networks and affiliates will start to bridge their differences to build a stronger future for the free over-the-air **TV** business."

Introductions will be very brief today; in other words, we'll probably just give people's titles and move right into discussion. Now, let's get down to business. We have a few goals. We're going to have three of them. First, we're going to have seven panels that discuss the issues, challenges, and opportunities facing the local TV broadcasters and the broadcast networks. And although we will be focused on what is happening today in the industry, we will also ask our panelists to project a bit and keep the future in mind. For many of the issues we raise, we will ask our panelists what the issue, challenge, and opportunity means in today's environment and what it will mean five years from now. We will be aided in each discussion by a well-qualified group of TV broadcast industry executives. The second goal is that we hope this day will further educate everyone who has traveled near and far. We hope you will leave with a better understanding of the complexity, challenges, and opportunities that members of the free over-the-air TV broadcasting business face. We hope that you get a sense of the pressures being placed upon the broadcast networks and local TV stations' economic models and **try** to get a sense of how these players are trying to adapt their models to respond to these pressures. There is a third goal: we will not dwell on the issues that divide the networks and the **affiliate** groups; and we will not pit these parties against themselves in our questions. We believe that these parties [the broadcast networks and the affiliates] have much more in common than they do not have in common. So we will **try** to focus on what unites the business, not on that which divides it. We are hopeful that the networks and affiliates will start to bridge their differences to build a stronger future for the free over-the-air TV business in general.

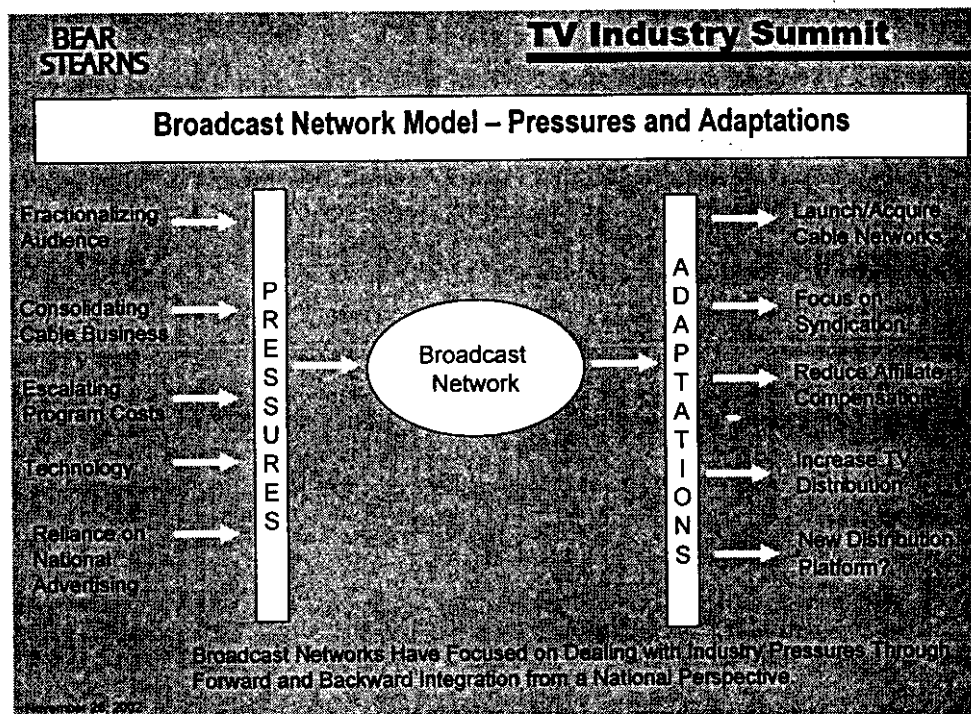
The next slide shows our agenda.

BEAR STEARNS **TV Industry Summit**

Agenda

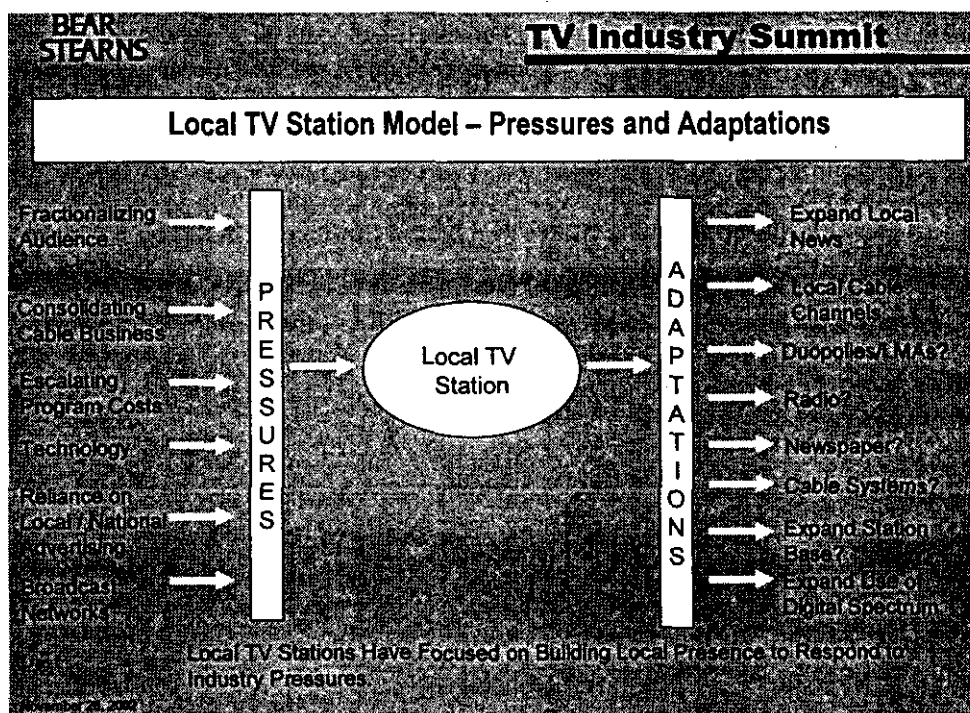
- Impact of Cable, DBS, and PVR Competition on Viewership and Advertising
- The Economics of Local TV Broadcasting
- Monopoly and Media Cross-Ownership
- Broadcast Network Economics
- The Health of Small- and Mid-Market Television
- Digital TV Update
- Issues Facing the Television Business – Washington Perspective

November 22, 2001



Now, what we're going to spend time on is talking about the pressures that these businesses are undergoing. First, this is just the broadcast network business. Obviously, they're facing fractionalizing audience from the seven existing networks and the 70-plus viable cable networks. The consolidating cable business; obviously, AT&T, Comcast, and what that's going to mean for the industry as the cable business

consolidates. Escalating programming costs, even in the throes of having a smaller and declining audiences. Technology with broadband and compression . . . and a reliance on a national advertising as your sole source of income. All those pressures are being exerted onto the broadcast networks. And what have they done to respond or adapt to those pressures? Well, they have launched cable networks, they've focused on the syndication business; they've gone to reduce affiliate compensation; they've increased their TV distribution bases — through duopolies and just buying more television stations. And, of course, we're wondering if any new distribution platforms develop. Now, I think the question we'll have is, what happens in the business five years from now? We're unlikely to launch new cable networks. Syndication business is what it is. Affiliate compensation, last time I checked, is theoretically going to be going to zero at some point. So all these pressures, as they continue to mount, are going to flow right through here [the increase in TV distribution, which requires a relaxation of the national television ownership reach cap, which currently stands at 35% of U.S. TV households]. And this is the debate of what's going to happen here: whether the networks are going to see any kind of increase in their television distribution base to deal with some of these pressures.



“While the networks are looking at protecting their franchise from a national perspective, the local TV stations are trying to protect themselves mostly from a local position.”

In the next slide, we bring it down to the local station level. And while the networks are looking at protecting their franchise from a national perspective, the local TV stations are trying to protect themselves mostly from a local position. So, they have all the same things: fractionalizing audience, consolidating cable business, escalating cost, threat of technology, reliance **on** one revenue stream called advertising. And they also have the broadcast networks to contend with. All those pressures are being exerted on that local television station model. And how are they responding? They're expanding local news, adding local cable channels, trying to create duopolies and local marketing agreements (LMAs) . . . cross-ownership with radio, newspapers, cable systems . . . expanding their own station bases, and expanded use of the digital spectrum. So the way that the local TV station business, we think, **is** hying to adapt

to the pressures being exerted is to create an impenetrable local force to basically fend off the incoming national horde. So that's just the model to think about.

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Relative Valuation: Television Versus Radio

	Local Television	Local Radio
Industry Structure	Local TV	Local Radio
Competition	Audience fractionalizing Eight new broadcast networks 70-plus viable cable networks	Listenership stable Satellite radio - small impact to date
Networks	Very powerful	Not powerful
Advertising	Very competitive Pressure on CPM Losing share relative to other measured media	Gaining share relative to measured media
Content	Ratings systems Mandated children's programming hours V-Chips	None
Cost	\$4-\$6 billion industry investment	\$750 million industry investment

Industry Structure Favors Radio

Wednesday, 28, 2002

“The bottom line is, why the multiple disparity? **Because the structure of the radio business is healthier.**”

Next, the question is, why does local radio trade at 17.7x cash flow on a forward basis, while local TV is five multiple points less? Competition — we have audience fractionalization, eight new broadcast networks, 70-plus viable plus cable networks. Listenership is fairly stable, and right now, satellite radio has had a small impact. The networks are very powerful in local TV, not as powerful in local radio. Advertising, very competitive on local television — we'll get into that; pressures on the cost per thousands and losing share relative to other measured media. Radio gaining share. Content — we have to have ratings systems, mandated children's programming hours, V-chips to contend with in local TV. Radio has none of that. The digital conversion is costing the television broadcast industry **\$4-\$6 billion**, the radio business will probably be \$750 million to convert to digital. So, the bottom line is, why the multiple disparity between public radio and television companies? Because the structure of the radio business is healthier. And now what we're going to do is talk about the structure of the broadcast network business model and the television station model and how they're responding to these pressures and also what the structure of the business should look like in the future.